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Mind the Gap

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NEW HAVEN

The Senate debate over President Bush's tax plan has focused so far on the plan's short-term effects, like whether a reduction in the dividend tax will help the stock market. While economic stimulus is important, Congress and the president should also take up an issue with far more consequence for America's long-term growth and stability: economic inequality.

According to the Census Bureau, the bottom 40 percent of American families earned 18 percent of the national income in 1970, but by 1998 they earned only 14 percent — and that figure could fall to 10 percent before too long. On a global scale, too, inequality is a problem. Per capita gross domestic product in India in 2000 was only 7 percent of that of the United States, and for China the figure was 11 percent. Such a difference could increase the possibility of greater inequality within America.

The prospect of worsening inequality is truly frightening, but in the present political environment, there appears little that can be done. In fact, Washington can act now to help prevent inequality from worsening. Without making any changes in tax rates, it could reform the tax system so that it automatically prevents economic inequality from getting any worse.

The tax cut passed two years ago was fairly conventional. Tax rates and brackets were mostly indexed to the Consumer Price Index. President Bush's current tax plan proposes some minor adjustments in this plan that accelerate the tax reductions.

This basic framework for tax law doesn't make much sense. Instead, future tax brackets and rates should be contingent on the extent of future inequality. Tax law should be based on a principle that might be called inequality insurance: the taxes would be collected in such a way as to insure that the level of inequality, after taxes and transfers, does not exceed the levels present when the law was enacted. If such indexing were put in place today, the brackets and rates would adjust whenever inequality worsened beyond today's levels.

If the nature of the economy changes, and a small number of people capture the lion's share of pretax income, then the tax rates on them would automatically rise, and the tax rates on lower-income people decline, until today's level of inequality was restored. Higher taxes on the high incomes would be imposed exactly at a time when the few are suddenly becoming enriched relative to the many. There would be no delays while politicians debated whether taxes should be raised or cut.

Reframing the tax system in this way could help deal effectively with one of the world's most serious problems, which is the potential for growing inequality. Highly talented, educated and hard-working people living in less developed countries often earn only a small fraction of what their counterparts in advanced countries earn. As Americans increasingly compete on a world market, there is a serious risk that their jobs will be given to people overseas and their incomes will drop precipitously — producing

sudden profit opportunities for other Americans and creating sharp increases in inequality here.

No doubt there would be strident opposition, especially among Republicans, to a tax system that would produce automatic tax increases for the wealthy. But the issue is not just what is best for the wealthy; it is how to create a just society with better opportunities for all. Not even the most antitax Republicans want a gratuitously unequal society that could create resentment and even violence.

Besides, the prospect of future tax increases that are contingent on changes in the distribution of wealth may not be as politically unlikely as it seems. After all, high rates on the very rich would be put in place only after it became much easier to get rich. The new system could be designed so it would always be just as easy for people to attain the same relative economic status that the upper segments of society enjoy today. There is no reason to worry that more wealthy people will feel any less of an incentive to work hard than they do now.

The political argument is true in at least one sense, however: this change will become only more difficult as inequality becomes more pronounced. When the top tenth of the population has attained such a high percentage of society's wealth that it can effectively block any reform, it can be counted on to use its power to keep its riches. America ought to act now to make to sure this never comes to pass.

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